2017

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In 2015, a sharply divided Supreme Court decided a landmark dormant Commerce Clause case, Comptroller of the Treasury of Maryland v. Wynne. Wynne *represents the Court's first clear acknowledgement of the economic underpinnings of one of its main doctrinal tools for resolving tax discrimination cases, the internal consistency test. In deciding* Wynne, *the Court relied on economic analysis we provided in an amicus brief. This Article explains that analysis, why the majority accepted it, why the dissenters' objections to the majority's reasoning miss their mark, and what* Wynne *means for state taxation. Essential to our analysis and the Court's decision in* Wynne *is the idea that states are capable of discriminating not only on an inbound basis, but also on an outbound basis, and that the Commerce Clause prohibits discrimination on either basis. To aid in explaining our position, this Article introduces the term "retentionism" as an analogue to protectionism. Whereas taxes or regulations are protectionist when they discourage outsiders from engaging in economic activities within a state, taxes or regulations are retentionist when they discourage in-state economic actors from engaging in out-of-state activities. As we show, the tax struck down in* Wynne *was both protectionist and retentionist.*

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INTRODUCTION

IN *Comptroller of the Treasury of Maryland v. Wynne,*[1] an unusually aligned and closely divided Supreme Court struck down a Maryland state tax regime as inconsistent with the dormant Commerce Clause of the U.S. Constitution.[2] Commentators hailed *Wynne* as the most important state tax decision in decades, and even the most important decision of the 2014–15 Term.[3] How is it possible that a state tax case has a claim to be the most important decision in a Term that saw landmark de-

[1] 135 S. Ct. 1787 (2015), aff'g sub nom., 64 A.3d 453 (Md. 2013).

[2] Justice Alito wrote the majority opinion, joined by Chief Justice Roberts and Justices Kennedy, Breyer, and Sotomayor. Justice Scalia wrote a dissent, which Justice Thomas joined in part. Justice Thomas wrote his own dissent, in which Justice Scalia partially joined. Finally, Justice Ginsburg wrote the principal dissent, joined by Justices Kagan and Scalia. Id. at 1791.

[3] Gary Thompson, Op-Ed: A Tax Case (Yes, Tax) was Last Term's Blockbuster, Nat'l L.J. (Aug. 31, 2015), http://www.nationallawjournal.com/id=1202735954030/OpEd-A-Tax-Case-Yes-Tax-Was-Last-Terms-Blockbuster (highlighting *Wynne* as the standout in what he described the Term's "epic docket"). See also Brannon P. Denning & Norman R. Williams, *Wynne*: Lose or Draw?, 67 Vand. L. Rev. En Banc 245, 245 (2014) (describing *Wynne* as "the most important state tax case since . . . 1992" (citing David Sawyer, Tax Observers Say *IBM* and *Wynne* are Cases to Watch, Tax Analysts, St. Tax Notes Mag., Sept. 1, 2014, at 558 (quoting tax practitioner's perspective that *Wynne* was "probably the most important U.S. Supreme Court case . . . in the last 30 years"))).

cisions on marriage equality,[4] redistricting,[5] lethal injection,[6] and the interpretation of the Affordable Care Act?[7]

Before *Wynne*, because there was no clear description of tax discrimination that applied in every case, courts and litigants relied on intuition to identify discrimination, which predictably led to claims that the concept was unprincipled. Some of the harshest criticism came from the Supreme Court itself. As far back as the 1940s, the Court referred to its tax discrimination jurisprudence as a "quagmire"[8] and "tangled underbrush."[9] Such criticism has not ebbed. For example, in his dissent in *Wynne*, Justice Scalia described the "glaring defect" of the dormant Commerce Clause as "its lack of [a] governing principle."[10] He criticized the Court's doctrine for its "instability,"[11] calling it a "bestiary of ad hoc tests and ad hoc exceptions."[12] Likewise, prominent commentators have described the Court's tax nondiscrimination doctrine as "confused and inconsistent,"[13] as having a "wild west quality to it"[14] and "characterized by meaningless distinctions, encrusted rules, and a lack of principled analysis."[15]

Such criticism is typical of tax nondiscrimination standards, which require courts to balance state-tax-autonomy interests against the value

[4] Obergefell v. Hodges, 135 S. Ct. 2584 (2015).

[5] Ariz. State Legislature v. Ariz. Indep. Redistricting Comm'n, 135 S. Ct. 2652 (2015).

[6] Glossip v. Gross, 135 S. Ct. 2726 (2015).

[7] King v. Burwell, 135 S. Ct. 2480 (2015).

[8] Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457–58 (1959); see also Wardair Can., Inc. v. Fla. Dep't of Revenue, 477 U.S. 1, 17 (1986) (Burger, C.J., concurring in part and concurring in the judgment) (referring to "the cloudy waters of this Court's 'dormant Commerce Clause' doctrine").

[9] *Nw. States Portland Cement Co.*, 358 U.S. at 457 (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445 (1940)).

[10] *Wynne*, 135 S. Ct. at 1809 (Scalia, J., dissenting).

[11] Id. Justice Scalia describes the Court's practice in this area dating back to the 1870s as tending "to revamp the doctrine every couple of decades upon finding existing decisions unworkable or unsatisfactory." Id. at 1808.

[12] Id. at 1809.

[13] Tracy A. Kaye, Tax Discrimination: A Comparative Analysis of U.S. and EU Approaches, 7 Fla. Tax Rev., no. 2, 2005, at 47, 80.

[14] Id. at 91 (quoting Professor Kirk Stark).

[15] Id. at 91 n.278 (quoting Professor David F. Shores, State Taxation of Interstate Commerce—Quiet Revolution or Much Ado About Nothing?, 38 Tax L. Rev. 127, 128 (1982)).

of market integration.[16] In *Wynne*, the Supreme Court clarified its approach to this balancing under the dormant Commerce Clause by renewing its commitment to its own internal consistency test for identifying unconstitutional discrimination.[17] Importantly, the Court announced that the test should apply broadly to all kinds of taxes levied against all kinds of taxpayers.[18] The test is simple and powerful. When faced with a dormant Commerce Clause challenge to a state's tax rules, the reviewing court should assume that all fifty states apply the challenged rule. If, under the fifty-state-harmony assumption, cross-border commerce would bear more tax than purely in-state commerce, then the state tax is internally inconsistent and unconstitutionally discriminatory.

Under the regime challenged in *Wynne*, Marylanders paid county tax of up to 3.2 percent on their income, regardless of whether they earned it inside or outside Maryland.[19] Against the county tax due on income earned outside the state, Maryland offered no credits for other states' taxes. These rules resulted in unrelieved double taxation for the Wynnes. At the same time, Maryland imposed a tax of 1.25 percent on the Maryland income of residents of other states.[20]

When we universalize this Maryland tax regime, in-state income is always taxed at 3.2 percent, but cross-border income is always taxed at 4.45 percent. The Maryland regime is therefore internally inconsistent. The Court concluded that because Maryland's internally inconsistent tax regime burdened cross-border commerce more than in-state commerce, it violated the Constitution.[21]

After developing the internal consistency test in the 1970s and early 1980s,[22] the Court repeatedly narrowed the application of the test, leav-

[16] See generally Ruth Mason & Michael S. Knoll, What is Tax Discrimination?, 121 Yale L.J. 1014 (2012) [hereinafter Tax Discrimination] (reviewing criticisms of nondiscrimination standards in various legal contexts, focusing mainly on E.U. tax law).

[17] See *Wynne*, 135 S. Ct. at 1804.

[18] Id. at 1802–04.

[19] Id. at 1792.

[20] Id. at 1803.

[21] Id. at 1803–04. We show that, in addition to being protectionist, the Maryland tax regime was what we call retentionist; it discouraged residents from engaging in out-of-state activities. Retentionist policies are the mirror image of protectionist policies, and they similarly distort cross-border commerce.

[22] See Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) (articulating requirement of internal consistency); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272–74, 277–78 (1978) (applying analysis similar to the internal consistency test to conclude that a

ing commentators to wonder about its continued relevance.[23] Prior to *Wynne*, the Supreme Court had not struck down a state tax as internally inconsistent in thirty years.[24] *Wynne* not only removed doubts about the continued relevance of the test, but it acknowledged, for the first time, that economic analysis supports using internal consistency to identify unconstitutional discrimination in tax cases.

Of the fourteen amicus briefs filed in *Wynne*, two presented the economic case for the internal consistency test.[25] While each of the two briefs made the case in its own way, both made essentially the same economic argument. We wrote one of those briefs, and the other was written by eight prominent tax economists (the Tax Economists' Brief). The *Wynne* majority repeatedly referenced both briefs in its decision.[26]

We argued in the brief, as we have in our academic work, that the economic principle that motivates legal prohibitions on tax discrimination is what we call "competitive neutrality" or "a level playing field."[27] Competitive neutrality is the idea that states should not use their tax systems to distort the competitive advantages of residents of different states. Our earlier work provided support for that doctrinal conclusion in

state was free to adopt an apportionment formula that differed from the formula used by forty-four of the forty-six states imposing a corporate tax).

[23] Walter Hellerstein, Is "Internal Consistency" Dead?: Reflections on an Evolving Commerce Clause Constraint on State Taxation, 61 Tax L. Rev. 1, 2 (2007) (claiming pre-*Wynne* case law "reconfigured internal consistency doctrine and requires a rethinking of its more expansive applications").

[24] *Wynne*, 135 S. Ct. at 1821 (Ginsburg, J., dissenting).

[25] See Brief of Michael S. Knoll and Ruth Mason as Amici Curiae in Support of Respondents at 9–24, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485) [hereinafter Knoll Mason Brief]; Brief of The Tax Economists as Amici Curiae in Support of Respondents at 23–27, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485) [hereinafter Tax Economists' Brief]. In addition to these two briefs, friends of the court filed twelve other briefs in *Wynne*. Comptroller v. Wynne, SCOTUSBlog, http://www.scotusblog.com/case-files/cases/comptroller-v-wynne/. The Solicitor General filed a brief for the United States in support of Maryland. Brief for the United States as Amicus Curiae Supporting Petitioner, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485) [hereinafter Solicitor General's Brief].

[26] *Wynne*, 135 S. Ct. at 1802, 1804, 1806.

[27] See Knoll Mason Brief, supra note 25, at 9–18. For our prior academic work on the economic foundations of tax nondiscrimination rules, see Tax Discrimination, supra note 16; Ruth Mason & Michael S. Knoll, Waiting for Perseus: A Sur-Reply to Graetz and Warren, 67 Tax L. Rev. 375 (2014) [hereinafter Perseus]; Ruth Mason & Michael Knoll, A Brief Sur-Reply to Graetz and Warren, 123 Yale L.J. Online 1 (2013), http://www.yalelawjournal.org/forum/a-brief-sur-reply-to-professors-graetz-and-warren.

both the E.U. and U.S. contexts.[28] We showed in our amicus brief that the internal consistency test is a simple and predictable guideline for determining whether a state's tax rate regime is competitively neutral. We therefore urged the Supreme Court to uphold the decision of the Maryland Court of Appeals to strike down the challenged Maryland law because it was internally inconsistent.[29] The Tax Economists' Brief took the same position.[30] In *Wynne*, the Supreme Court not only renewed its commitment to the internal consistency test, but the majority made clear that a reason it endorsed internal consistency was the congruence between the test and the economic analysis that we and the tax economists presented in our amicus briefs.[31]

Although the *Wynne* majority put the internal consistency test on a firmer theoretical footing by referring to the economic analysis in the two briefs, the Court did not repeat that economic analysis in its opinion.[32] Similarly, while acknowledging the majority's reliance on the briefs, the dissent declined to address (or refute) the economic analysis we offered.[33] This makes it more difficult to conclusively draw the lesson from *Wynne* that the dormant Commerce Clause's nondiscrimination principle promotes competitive neutrality. Adding complexity, the parties in *Wynne* framed the central issue in the case as whether the dormant Commerce Clause requires a state to relieve double taxation.[34] These two notions—double taxation and tax discrimination—are not identical, and conflating them gives rise to persistent confusion that per-

[28] See Tax Discrimination, supra note 16, at 1085–97, 1106–15 (dealing mostly with E.U. cases, but also arguing that the same principle was at work in the U.S. jurisprudence). See also Ryan Lirette & Alan D. Viard, Putting the Commerce Back in the Dormant Commerce Clause: State Taxes, State Subsidies, and Commerce Neutrality, 24 J. L. & Pol'y 467, 495–500 (2016) (providing in-depth analysis of the U.S. doctrine).

[29] Knoll Mason Brief, supra note 25, at 18–24.

[30] Tax Economists' Brief, supra note 25, at 23–27.

[31] *Wynne*, 135 S. Ct. at 1804.

[32] Id. at 1801–06.

[33] Id. at 1822 n.7 (Ginsburg, J., dissenting) ("The majority faults the dissents for not 'disput[ing]' its 'economic analysis,' but beyond citation to a pair of *amicus* briefs, its opinion offers no analysis to dispute.") (alteration in original) (quoting id. at 1804).

[34] Brief for Respondents at i, 18–19, 25–27, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485) [hereinafter Wynnes' Brief]; Brief for the Petitioner at i, 27, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485) [hereinafter Maryland Comptroller's Brief].

vades dormant Commerce Clause doctrine, including the principal dissent in *Wynne*.[35]

This Article seeks to explain the significance of *Wynne* by exploring why the majority ruled as it did, why the dissenters' objections to the majority's reasoning miss their mark, and what *Wynne* means for state taxation. The first Part of this Article describes the facts of *Wynne*. Part II provides a brief introduction to the dormant Commerce Clause and the Court's tax discrimination jurisprudence. It also explores our theory that the dormant Commerce Clause promotes competitive neutrality. In Part III, we show that the internal consistency test accurately identifies state tax rate structures that violate competitive neutrality. As a result, we argue, as we did in our amicus brief, that the Court's internal consistency doctrine has a firm economic foundation. We also show that the Maryland tax regime challenged in *Wynne* was internally inconsistent. Part IV describes the *Wynne* majority's endorsement of the internal consistency test, which relied on the economic analysis in our amicus brief and that of the tax economists. In Part V, we critically examine the dissenting Justices' main criticisms of the Court's opinion, especially the dissent's arguments against the internal consistency test. We show that when the Court's majority opinion is properly understood as addressing tax discrimination, rather than double taxation, the dissenting Justices' objections lose their force. We then conclude.

I. THE FACTS OF *WYNNE*

The facts of *Wynne* are simple. Brian and Karen Wynne, a married couple residing in Maryland, owned stock in Maxim Healthcare Services, Inc. (Maxim), a Maryland corporation engaged in business throughout the United States.[36] Because it was an S corporation, Maxim paid no federal income tax; instead, Maxim passed through to its share-

[35] See Ruth Mason, Made in America for European Tax: The Internal Consistency Test, 49 B.C. L. Rev. 1277, 1284–89 (2008). A similar problem arises in the context of personal tax benefits, where courts have sometimes held that a cross-border taxpayer must receive benefits, such as the personal exemption, exactly once, somewhere. Our work shows that maintenance of competitive neutrality does not require fidelity to the "once, somewhere" principle. Tax Discrimination, supra note 16, at 1083 (concluding that "[c]hecking for double recoveries or double denials is no more effective a way to identify violations of competitive neutrality than is comparing absolute tax rates"); see also Perseus, supra note 27, at 421–22 (providing numerical example).

[36] *Wynne*, 135 S. Ct. at 1793.

holders all items of income and expense (including state taxes paid).[37] Maxim's shareholders, including the Wynnes, reported Maxim's pro-rata income on their personal federal income tax returns.[38]

State individual income taxes work similarly to national income taxes—specifically, two states typically have jurisdiction to tax an item of cross-border income. The "source state" has jurisdiction to tax income produced within its borders. At the same time, the "residence state" has jurisdiction to tax all the income of its residents, no matter where earned. Because these two jurisdictional bases overlap, cross-border income may be subject to double taxation. Typically, the residence state relieves such double taxation by crediting taxes assessed by the source state against the tax due at residence.

As residents of Maryland, the Wynnes had to pay Maryland tax on Maxim's income, no matter where Maxim earned it.[39] They also had to pay taxes on Maxim's income to the source states where Maxim earned it.[40] The dispute arose because Maryland did not credit taxes the Wynnes paid to other states against their Maryland tax on the same income.[41] Thus, they paid more tax on their income from other states than they would have paid on the same income, had they earned it in Maryland.[42] Phrased this way, it is easy to see why the parties, justices, and commentators originally understood this case to challenge the constitutionality of double taxation. Later, we will differentiate discrimination and double taxation, but for now we provide a little more detail on the challenged Maryland regime, which contained the following elements:[43]

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[37] Id. at 1793 n.1.

[38] Maryland follows federal tax law in treating S corporations as pass-through entities. Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 457–60 (Md. 2013), aff'd sub nom. Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015).

[39] *Wynne*, 135 S. Ct. at 1792–93.

[40] Id. at 1792.

[41] Id.

[42] See id.

[43] Maryland formally divided its individual income tax into two portions: a progressive "state" portion and a flat "county" portion, which varied by county. Id. In 2006, the year in question, the "state" portion had a maximum rate of 4.75%, and the "county" portion varied depending upon the county from 1.25% to 3.2%. See Md. Code. Ann., Tax-Gen. § 10-105(a) (1998) (amended 2008); Md. Code. Ann., Tax-Gen. § 10-106(a) (2010); Frey v. Comptroller of the Treasury, 29 A.3d. 475, 521, 521 n.5 (Md. 2011). The State collects both portions of the tax, but it remits the "county" portion to the counties. See Md. Code Ann., Tax-Gen. § 10-103 (2010); *Frey*, 29 A.3d. at 483, 521. Maryland allows its residents a credit against their "state" tax liabilities for taxes paid to other states up to the full amount of their "state"

For residents:

1. On income earned in Maryland, tax of 1.25% to 3.2%, depending on the county of residence (*domestic tax* or T_d).[44]

2. On income earned in other states, tax of 1.25% to 3.2%, depending on the county of residence (*outbound tax* or T_o), with no credit for other states' taxes.[45]

For nonresidents:

3. On income earned in Maryland, tax of 1.25% (Maryland calls this the Special Non-Resident Tax or SNRT; we also call it the *inbound tax* or T_i).[46]

4. On income earned in other states, no tax.

The Wynnes resided in Howard County, where the tax rate was 3.2%,[47] so the Wynnes paid tax of 3.2% on their income from domestic and outbound activities. *Figure 1* schematically represents the challenged Maryland tax regime for Howard County.

Figure 1. Maryland County Tax Regime

	MARYLAND RESIDENT	RESIDENT OF ANOTHER STATE
ACTIVITY IN ANOTHER STATE	*Outbound Tax* (T_o) 3.2%	N/A

tax liability (a full credit). Md. Code Ann., Tax-Gen. § 10-703(c) (2010). Maryland, however, does not allow its residents any credit against their "county" tax liabilities for taxes paid to other jurisdictions. See id. § 10-703(a). As a result, the Wynnes' challenge implicated the "county," rather than the "state" tax, and for simplicity we therefore deal only with the "county" portion of the tax.

[44] Md. Code Ann., Tax-Gen. § 10-103(a)(1) (2010); *Frey*, 29 A.3d at 521.

[45] Md. Code Ann., Tax-Gen. §§ 10-103(a)(1), 10-703(a) (2010); *Frey*, 29 A.3d at 521.

[46] Md. Code Ann., Tax-Gen. § 10-106.1(a)–(b) (2010); *Frey*, 29 A.3d at 521.

[47] William Donald Schaefer, Comptroller of Maryland, Maryland Withholding Tax Facts: January 2006–December 2006, http://taxes.marylandtaxes.com/Resource_Library/Tax_Publications/Tax_Facts/Withholding_Tax_Facts/Withholding_tax_facts_2006.pdf.

ACTIVITY IN MARYLAND	*Domestic Tax* (T_d) 3.2%	*Inbound Tax* (T_i) 1.25%

II. TAX NONDISCRIMINATION AS COMPETITIVE NEUTRALITY

The Commerce Clause of the Constitution grants Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[48] By its own terms, the Commerce Clause does not restrict state governments, but rather grants power to Congress. The dormant Commerce Clause is "the doctrine that the commerce clause, by its own force and without national legislation, puts it into the power of the Court to place limits upon state authority."[49] Although courts and scholars have endlessly debated whether the Commerce Clause should be interpreted to restrict state action even in the absence of direct congressional action, the Court has long interpreted the Commerce Clause to limit state action.[50]

Scholars and jurists recognize that dormant Commerce Clause doctrine aims to develop and maintain a smoothly functioning national marketplace.[51] Thus, for example, in 1949 the Court wrote that "[o]ur [economic] system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation."[52] Under the Court's doctrine, state taxes violate the dormant Commerce Clause when they *discriminate against* or *unduly burden* cross-border commerce.[53]

[48] U.S. Const. art. I, § 8, cl. 3.

[49] Felix Frankfurter, *The Commerce Clause* Under Marshall, Taney and Waite 18 (1937).

[50] Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 179 (1995).

[51] Underlying the Commerce Clause is the framers' "conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." Hughes v. Oklahoma, 441 U.S. 322, 325–26 (1979).

[52] H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 539 (1949).

[53] See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (describing the modern approach to resolving dormant Commerce Clause challenges to state taxes, where "decisions have considered not the formal language of the tax statute but rather its practical effect, and have sustained a tax against Commerce Clause challenge when the tax is applied

The dormant Commerce Clause prevents the states from enacting economic policies, especially tariffs, that advantage in-state commerce over cross-border commerce.[54]

The most important preliminary in any dormant Commerce Clause tax inquiry is to acknowledge that a state does not violate the dormant Commerce Clause merely by discouraging cross-border commerce. All taxes discourage commerce. But many taxes that discourage cross-border commerce do not offend the Constitution. For example, high tax rates in one state discourage commerce in that state by *both residents and nonresidents*. Such distortions are inevitable in a federal tax system that allows states autonomy to set their own tax rates. The dormant Commerce Clause only restrains certain distortions of cross-border commerce; this Part describes our view on the specific kind of distortion the dormant Commerce Clause forbids, namely, distortions to what we call competitive neutrality. *Wynne* makes clear that a majority of the Supreme Court shares our view.[55]

In prior work, we focused primarily on the European Union when making the doctrinal case for a competitive neutrality interpretation of tax discrimination, although we also discussed the dormant Commerce Clause.[56] Although we argued that doctrine reveals competitive neutrality to be the value undergirding the dormant Commerce Clause, we did not invent the idea of competitive neutrality out of thin air. We based our approach to tax discrimination on a solid economic foundation: The age-old economic principle of comparative advantage, which holds that an economic actor (for example, a nation, corporation, or individual) will specialize in those activities where it enjoys a comparative ad-

to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State" (citations omitted)).

[54] West Lynn Creamery v. Healy, 512 U.S. 186, 192–93 (1994) (striking down a tax that functioned as a tariff and describing tariffs as "[t]he paradigmatic example of a law discriminating against interstate commerce").

[55] See infra Part IV.

[56] See Tax Discrimination, supra note 16, at 1085–97 (addressing the E.U. cases); id. at 1106–14 (addressing the U.S. state cases). Among other examples, we cited *West Lynn Creamery*, in which the Supreme Court struck down under the dormant Commerce Clause a state tax regime because it "neutraliz[ed] the advantage possessed by lower cost out-of-state producers" and "artificially encourag[ed] in-state production even when the same goods could be produced at lower cost in other States." *West Lynn Creamery*, 512 U.S. at 193–94.

vantage and will avoid those activities where it has a comparative disadvantage.

In the absence of tariffs, quotas, taxes, or other potential distortions, the activities an economic actor specializes in are determined not by absolute advantage, but rather by comparative advantage.[57] Policy instruments, such as tariffs, can distort economic activity by changing an actor's perceived (in our case, after-tax) comparative advantage relative to her actual comparative advantage. When we translate the idea of comparative advantage from the familiar context of tariffs on goods and services to the less familiar context of taxes on income, *earning income* takes the place of *production of goods and services*. Whereas tariffs distort *which goods and services are produced in a state*, discriminatory income taxes distort *in which state a person earns income*.[58]

In our view, every discriminatory tax results in two distortions to where people earn income, and these distortions run in opposite directions. When the state's tax regime undermines the comparative advantage of nonresidents who earn income within the state relative to residents who earn income within the state, economists refer to the regime as protectionist. Economists have not invented a special term to describe the distortion that happens when a state's tax regime undermines the comparative advantage that residents have over nonresidents on income earned outside the state. We refer to such distortions as retentionist. Protectionist taxes keep outsiders out; retentionist taxes keep insiders in.

The Wynnes' complaint involved the retentionist impact of Maryland's tax regime—specifically, the Wynnes argued that Maryland discouraged them from earning out-of-state income.[59] But, as we explain

[57] Our approach is also based on modern portfolio theory, especially the theory of portfolio choice in an environment with taxes. See, e.g., Michael J. Brennan, Taxes, Markets Valuation and Corporate Financial Policy, 23 Nat'l Tax J. 417, 417, 420–22 (1970).

[58] Our approach is also closely related to the literature on capital ownership neutrality (CON). See Tax Discrimination, supra note 16, at 1051–72. A tax system is said to promote CON when it does not distort *who* owns capital. Id. at 1053–54. In contrast, a tax system is said to promote capital export neutrality (CEN) when it does not distort *where* (in which jurisdiction) taxpayers invest their capital. Id. at 1043. Our argument is that the dormant Commerce Clause is concerned with the "who" question, not the "where" question. When we refer to discouraging cross-border commerce relative to in-state commerce (and the shorthand "discouraging interstate commerce"), we refer to distortions of ownership, not location.

[59] Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 460 (Md. 2013), aff'd sub nom. Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015).

later, all discriminatory taxes have both protectionist and retentionist impacts. While the Wynnes complained about the retentionist impact of Maryland's tax regime, the same tax regime also generated a complementary protectionist effect. Although the protectionist effect of the Maryland tax regime was not at issue in *Wynne*, we can describe it. Because the Maryland tax regime discouraged Marylanders from earning out-of-state income, it upset the comparative advantage nonresidents may otherwise have had over Marylanders when competing for work and investments in Maryland. That effect is protectionist. Indeed, at least some nonresident taxpayers understood this effect well enough to challenge the same Maryland regime as protectionist in *Frey v. Comptroller of the Treasury*, a case decided four years prior to *Wynne*.[60] We discuss *Frey* later.[61]

In contrast with our comparative-advantage approach, it is common and (to most non-economists) intuitive to assume that the impact of taxes on competition can be understood by comparing absolute tax rates. That intuition is wrong. Assume, as in *Wynne*, that we are trying to determine the impact of Maryland's tax regime on cross-border commerce. To do so, we need to look beyond Maryland to alternative investment opportunities open to Marylanders and residents of other states. The competitive position of an economic actor considering working or investing in a particular market is determined by simultaneously comparing tax rates across both taxpayers and economic opportunities. Crucial to this economic analysis is the idea, widely accepted in economics, that people make decisions based on comparisons of their options across different markets *relative to their competitors' options across the same markets*.[62] Thus, to identify the impact of state taxes on economic actors, we must compare

[60] Frey v. Comptroller of the Treasury, 29 A.3d. 475, 484, 493 (Md. 2011), cert. denied 132 S. Ct. 1796 (2012) (mem.).

[61] See discussion accompanying infra notes 73–80.

[62] See, e.g., Brennan, supra note 57 (developing after-tax CAPM); Myron Scholes et al., Taxes and Business Strategy 142–43 (4th ed. 2009) (explaining tax clienteles); David Ricardo, On the Principles of Political Economy and Taxation (1817) (developing the principle of comparative advantage).

(1) how an economic actor is taxed *in the particular market under consideration* relative to how that actor is taxed in *alternative markets*

with

(2) how that actor's competitors are taxed *in the particular market* relative to the *alternative markets*.[63]

Thus, we must compare two comparisons. And accordingly, even if Maryland taxes *nonresidents at a lower rate than residents* on income earned in Maryland, it does not follow that Maryland provides nonresidents with a tax-induced competitive advantage over residents for income earned in Maryland. Rather, an actor has a competitive advantage in a particular market over a second actor only if the share of pre-tax income the first actor retains in that market relative to the share of pre-tax income the actor retains in other markets exceeds that same ratio for the second actor.[64]

Our approach is also consistent with commonly observed behavior. Residents of high-tax states (such as California and New York) hold many taxable investments despite being taxed more heavily on those same investments than potential investors from lower-taxed states (such as Florida). If absolute tax rate advantages were determinative, residents of high-tax states would be discouraged from holding investments in low-tax jurisdictions and from holding investments, such as equities and debt, which are taxed only where the holder resides.

As this short discussion suggests, and as our prior work shows in detail, deciding whether a tax system is neutral between in-state and cross-border commerce (is "competitively neutral," in our parlance) requires consideration of how a state taxes *both* residents and nonresidents on *both* in-state and out-of-state income.[65]

[63] Tax Discrimination, supra note 16, at 1060–72; Perseus, supra note 27, at 436–52.
[64] Tax Discrimination, supra note 16, at 1060–72.
[65] Perseus, supra note 27, at 436–52 (demonstrating numerical derivation of these principles).

Our principal result can be expressed as requiring that all taxes must be assessed on either a *uniform source* or a *uniform residence* basis.[66] A source tax is uniform if it applies at the same rate and on the same base[67] to both residents' and nonresidents' income from the state.[68] A residence tax is uniform if it applies at the same rate and on the same base to residents' in-state and out-of-state income.[69] Accordingly, if a state taxes on both a source and residence basis, it must apply *both* source and residence taxes to its *residents'* in-state income.[70] More generally, if a tax system can be decomposed into a series of uniform source and residence taxes, then it is competitively neutral, and conversely, if it cannot be decomposed into uniform source and residence taxes, then it is not competitively neutral.

The uniformity rule can be used to evaluate any tax discrimination claim, whether it involves a challenge to the tax rates, the tax base, or both. In the limited situation, as in *Wynne*, where a taxpayer challenges only the tax rates (not the tax base), the above logic reduces to a simple mathematical formula. The requirement that a state must apply both its source and residence taxes to its own residents (coupled with a recognition that the dormant Commerce Clause prohibits discouraging cross-border commerce relative to in-state commerce but does not prohibit encouraging such cross-border commerce relative to in-state commerce) implies that the tax rate assessed by a state on its residents' domestic-source income, T_d, must equal or exceed the combined tax imposed on domestic residents' out-of-state income, T_o, and nonresidents' in-state income, T_i. Arithmetically, this can be written as *Condition 1*:

$$T_d \geq T_o + T_i - (T_o \times T_i)^{71}$$

[66] Tax Discrimination, supra note 16, at 1060–74 (describing uniformity requirements for taxes not to distort competition).
[67] "Tax base" refers to the rules for calculating taxable income.
[68] See Tax Discrimination, supra note 16, at 1064.
[69] Id. at 1055.
[70] See id. at 1060–72; Lirette & Viard, supra note 28, at 545–46.
[71] The last term on the right side of the inequality represents the interaction between the tax laws of the source and residence states. It assumes that the residence state would allow a deduction from taxable income (not a credit against tax due) for the taxes assessed by the source state. For a numerical example, see infra note 134 and Figure 3.

That is, the tax rate a state applies to residents' domestic income must equal or exceed the sum of *the tax rate it applies to residents' out-of-state income and the tax rate it applies to nonresidents' domestic income* less *the product of those two rates*. If a state's tax rates do not satisfy *Condition 1*, its tax system discourages cross-border competition.[72] Notice that *Condition 1* does not specify the rates; rather, it specifies the relationship among the rates. A state may set its tax rates high or low. And a state may set any two of the three tax rates in *Condition 1* as it chooses. However, the choice of those two rates restrains the third. Thus, the dormant Commerce Clause prevents a state from setting its tax on domestic income independently from its tax on cross-border (inbound and outbound) income.

In contrast with our approach, when litigating disputes under the dormant Commerce Clause, states and taxpayers often argue that the presence or absence of tax discrimination can be conclusively determined by comparing the tax rate the challenged state imposes on a resident taxpayer to the tax rate the state imposes on a nonresident taxpayer. Advocates of this view thus believe that tax discrimination determinations can be made by comparing absolute tax rates.

Frey v. Comptroller of the Treasury,[73] the case mentioned earlier, illustrates why this approach is wrong. The Maryland Court of Appeals decided *Frey* in Maryland's favor just two years before it decided *Wynne* against Maryland.[74] *Frey* involved a challenge to the exact same Maryland tax regime at issue in *Wynne*, only in *Frey*, the taxpayer was a nonresident who earned income in Maryland and challenged Maryland's inbound tax rate.[75] In other words, Frey complained about the protectionist aspect of the Maryland regime, while the Wynnes complained about its retentionist aspect. On our theory, those two effects are complementary, and both are present in every discriminatory tax.

In defending Maryland's tax regime in *Frey*, the Maryland Comptroller took the position that tax discrimination could be conclusively de-

[72] See Perseus, supra note 27, at 436–41 (providing formal derivation of nondistortion conditions).

[73] 29 A.3d. 475 (Md. 2011).

[74] Compare id. at 520 (holding that Maryland's SNRT was constitutional), with Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 470 (Md. 2013), aff'd sub nom. Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (holding that the same tax regime that had been challenged and upheld in *Frey* was unconstitutional).

[75] *Frey*, 29 A.3d at 484.

termined by comparing Maryland's tax on resident taxpayers to its tax on nonresident taxpayers. The Comptroller argued that because Frey was a nonresident, the court should compare Maryland's *domestic tax rate* to Maryland's *inbound tax rate*.[76] The Maryland Court of Appeals agreed that this was the correct comparison. Having accepted the Comptroller's comparison and because the inbound rate (T_i = 1.25%) was lower than the domestic rate (T_d = 3.2%), the Maryland Court of Appeals never considered the impact on cross-border commerce of the other component of Maryland's tax regime, namely, Maryland's outbound tax rate (T_o = 1.25%).[77]

In *Wynne*, the Maryland Comptroller made nearly the same argument. However, since the Wynnes were Maryland residents with out-of-state income, the Comptroller argued that this time the relevant comparison of absolute tax rates was between Maryland's *domestic tax rate* (T_d = 3.2%) and Maryland's *outbound tax rate* (T_i = 3.2%).[78] To the Comptroller, Maryland's inbound tax rate in *Wynne*, like its outbound tax rate in *Frey*, was simply irrelevant.

The Comptroller's framing in each case represents a simple comparison of absolute tax rates. Expressed mathematically, in *Frey* the Comptroller argued that the dormant Commerce Clause requires that $T_d \geq T_i$. In *Wynne*, the Comptroller argued that the dormant Commerce Clause requires that $T_d \geq T_o$. Combining these two arguments, we arrive at the Maryland Comptroller's notion of the nondiscrimination condition, *Condition 2*:

$$T_d \geq T_i \ and \ T_d \geq T_o.$$

Thus, combining *Frey* and *Wynne*, we can see that Maryland argued that as long as each of its inbound and outbound tax rates *taken alone* did not exceed its domestic tax rate, Maryland did not discriminate. What Maryland ignored was that the burden its tax system places on cross-border commerce compared to the burden its tax system places on in-state commerce depends on comparing the domestic tax rate to the *cumulative* burden Maryland places on cross-border commerce. That

[76] Id. at 510.
[77] See id. at 483–84.
[78] Maryland Comptroller's Brief, supra note 34, at 14–15; see *Wynne*, 135 S. Ct. at 1792.

cumulative burden can be evaluated only by considering Maryland's *in-bound and outbound taxes together*. Maryland's argument is based on a mistaken implicit assumption: That the competitiveness of two taxpayers relative to one another in a specific market depends solely on absolute advantages, that is, on how those two taxpayers are taxed *solely by Maryland*.

Although the Maryland Comptroller's reasoning may be intuitive, economic analysis shows that it is wrong. Absolute tax rate comparisons across competitors in the contested market (such as that offered by the Comptroller in both *Wynne* and *Frey*) are misleading. By disaggregating its inbound and outbound taxes, Maryland was able to persuade the Maryland Court of Appeals in *Frey* that the Maryland regime did not offend the Constitution.[79] But when the exact same regime was challenged in *Wynne*, the same Maryland court found it unconstitutional.[80]

The difference between *Frey* and *Wynne* is that in *Wynne* the Court of Appeals used the internal consistency test.[81] As we show below, the internal consistency test automatically aggregates a state's taxes on inbound and outbound commerce, and, therefore, it prevents a state from obscuring discrimination against cross-border commerce in disparate elements of its tax regime.[82] The internal consistency test works because it tests for whether a state's tax regime upsets comparative advantage. Thus, it moves the inquiry away from the kinds of absolute comparisons offered by the Maryland Comptroller in *Frey* and *Wynne*.

III. THE RELATIONSHIP BETWEEN COMPETITIVE NEUTRALITY AND THE INTERNAL CONSISTENCY TEST

Writing separate amicus briefs, we and the tax economists urged the Court to apply the internal consistency test in *Wynne*.[83] We (and they) advocated for the test for the same reason: That test greatly aids courts

[79] *Frey*, 29 A.3d at 520.
[80] Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 471 (Md. 2013), aff'd sub nom. Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015).
[81] Compare *Frey*, 29 A.3d. at 515–16, 520 (not applying internal consistency test), with *Wynne*, 64 A.3d at 463–67 (applying internal consistency test).
[82] See infra Part III.
[83] Knoll Mason Brief, supra note 25, at 2, 4, 10; Tax Economists' Brief, supra note 25, at 23–27.

in determining whether state tax regimes violate competitive neutrality.[84] Our recommendation was out of step with contemporary views of the utility of the internal consistency test and three decades of Supreme Court jurisprudence, which had consistently narrowed its application. Before *Wynne*, at best, commentators regarded the internal consistency test as merely duplicating other doctrinal principles.[85] Other commentators were far more critical of the test, including Justice Scalia, who in *Wynne* described the internal consistency test as unprincipled "ad hocery."[86] Because the virtue of the internal consistency test in identifying state tax regimes that violate competitive neutrality was unappreciated, it was far from obvious that the Court would redouble its commitment to the test in *Wynne*. The opposite seemed possible because the Court had repeatedly narrowed the test since formally adopting it in 1983.[87] Indeed, so precarious was the doctrine after a series of decisions narrowing it that in 2007, Walter Hellerstein, a leading expert on state taxation, wrote an article entitled, "Is Internal Consistency Dead?"[88]

The Court's clearest statement of the internal consistency test came in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*:

[84] Knoll Mason Brief, supra note 25, at 9–28; Tax Economists' Brief, supra note 25, at 23–27; see also Tax Discrimination, supra note 16, at 1023 (arguing "that the principle of non-discrimination in taxation should be understood as promoting competitive neutrality"); Lirette & Viard, supra note 28, at 509–16 (describing the Court's adoption of internal consistency in *Wynne* as a step forward).

[85] See Walter Hellerstein, Is "Internal Consistency" Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation, 87 Mich. L. Rev. 138, 188 (1988) (concluding that the Supreme Court could have decided cases in which it applied the internal consistency test by appeal to older dormant Commerce Clause doctrines rather than inventing a new test that "may introduce confusion and uncertainty in an area of the law that has had more than its fair share of both"). Such analysis fails to recognize that the internal consistency test does a better job than other doctrines (such as fair apportionment) of effectuating the economic principle behind the dormant Commerce Clause, namely, competitive neutrality.

[86] *Wynne*, 135 S. Ct. at 1809 (Scalia, J., dissenting).

[87] Before *Wynne*, the Supreme Court had not invalidated a state tax for lack of internal consistency since a pair of decisions issued on the same the day in 1987. See Am. Trucking Ass'ns v. Scheiner, 483 U.S. 266, 269, 284 (1987) (invalidating as internally inconsistent a state's fixed fee on trucks operating in-state); Tyler Pipe Indus. v. Wash. Dep't of Revenue, 483 U.S. 232, 248 (1987) (invalidating as internally inconsistent a state's manufacturing and wholesaling tax). But see Am. Trucking Ass'ns v. Mich. Pub. Serv. Comm'n, 545 U.S. 429, 437–38 (2005) (upholding an internally inconsistent state tax regime); see also Hellerstein, supra note 23, at 2 (analyzing several cases narrowing the application of the internal consistency test since 1987, but ultimately concluding that "reports of its demise are premature" even after the 2005 *American Trucking* case).

[88] Hellerstein, supra note 23.

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every state in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.[89]

Thus, the internal consistency test directs a court to assume that every state enacts the challenged state's tax regime, and then it asks whether, under such hypothetical harmonization, cross-border commerce bears more tax than purely in-state commerce.

Figure 2 shows how income would be taxed if every state (represented here by New Jersey) adopted the Maryland tax regime as employed in Howard County:

[89] 514 U.S. 175, 185 (1995).

Figure 2. Maryland Tax under the Internal Consistency Test

	MARYLAND RESIDENT	NEW JERSEY RESIDENT
ACTIVITY IN NEW JERSEY	4.45%	3.2%
ACTIVITY IN MARYLAND	3.2%	4.45%

As *Figure 2* shows, the Maryland tax regime is internally inconsistent because under hypothetical harmonization, domestic income (the unshaded quadrants) would be taxed at only 3.2%, whereas cross-border income (the shaded quadrants) would be taxed at 4.45%.[90] Applying the internal consistency test, the Supreme Court, like the Maryland Court of Appeals before it, concluded that the Maryland tax regime violated the dormant Commerce Clause.[91]

In urging the Court to apply internal consistency in *Wynne*, we noted in our amicus brief the close similarities between the internal consistency test and both (1) our uniformity rule and (2) *Condition 1*. With regard to the first similarity, the internal consistency test reveals whether the state taxes uniformly on a source and residence basis. Uniform taxes pass the internal consistency test; non-uniform taxes fail it. The second similarity arises when the challenge is to a state's system of tax rates (without credits), as in *Wynne*. In such situations, the internal consistency test is equivalent to *Condition 1* and to our uniformity requirement.

The equivalence of the internal consistency test to both *Condition 1* and the uniformity principle is easy to see. The unshaded quadrants in *Figure 2* contain only the Maryland tax rate on domestic income (T_d in *Condition 1*). The shaded quadrants show the combined Maryland tax rate on outbound (T_o) and inbound (T_i) income. By directing a court to

[90] Cross-border income pays T_i, the inbound tax, plus T_o, the outbound tax. The inbound tax is 1.25% and the outbound tax is 3.2%, for a total of 4.45%. In contrast, purely in-state income pays only T_d, the domestic tax, of 3.2%.

[91] See *Wynne*, 135 S. Ct. at 1792.

strike down a state tax unless the tax rate that appears in the two unshaded quadrants (T_d) equals or exceeds the rate in the two shaded quadrants, the court is simply applying *Condition 1*, which is just a mathematical statement of our uniformity principle. Thus, the internal consistency test asks the right question, although it presents it in a conceptual, rather than a mathematical, form.

IV. THE MAJORITY'S ENDORSEMENT OF OUR ECONOMIC ANALYSIS

We argued in our amicus brief—and a majority of the Court agreed—that *Wynne* was a discrimination case. In contrast, the taxpayers, the Maryland Comptroller, the U.S. Solicitor General's office, and the principal dissent framed the issue in *Wynne* as whether the Constitution forbids double state taxation.[92] This Part describes the litigants' arguments and the Court's holding in *Wynne.*

The Wynnes and Maryland built their arguments on the same shaky economic foundation. Both parties' arguments derive from the mistaken premise that one can ascertain how taxes impact competition in a given market by comparing absolute tax rates paid by competitors in that market. The Wynnes argued that the relevant comparison was between (1) the total tax rate (both the source state tax rate and the residence state tax rate) they *actually paid* on cross-border commerce and (2) the tax they *would have paid* on purely domestic commerce.[93] Because Maryland did not credit source state taxes, Maryland taxpayers who had income from other states paid higher total taxes on their out-of-state income than they would have paid on an equivalent amount of Maryland income.[94] In the

[92] Wynnes' Brief, supra note 34, at i (posing the question presented as "[w]hether a state tax that exposes interstate commerce to double taxation is saved from invalidation under the Commerce Clause merely because the State imposes the tax upon its own residents"); see id. at 14–27 (analyzing *Wynne* as a double tax case); Maryland Comptroller's Brief, supra note 34, at 26–32 (same); Solicitor General's Brief, supra note 25, at 9–19 (same). Several amici supporting the Wynnes also framed the issue in terms of double taxation. See, e.g., Brief of the Maryland Chamber of Commerce as Amicus Curiae in Support of Respondents at 5, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485) ("The well-established dormant Commerce Clause principles protecting interstate commerce from multiple taxation are . . . applicable . . . ."); see also *Wynne*, 135 S. Ct. at 1813–23 (Ginsburg, J., dissenting) (framing the case as focusing on double taxation).

[93] Wynnes' Brief, supra note 34, at 14–27.

[94] This was true at least when the other state imposed income taxes, which the vast majority did. Under Maryland's system, which did not credit other states' taxes against Maryland county tax, Maryland taxpayers who earned income outside Maryland would pay at least the

Wynnes' view, the higher taxes they paid on outbound income compared to an equivalent amount of in-state income discouraged them from earning income outside Maryland and hence violated the Commerce Clause.[95]

Maryland accepted the taxpayer's economic frame—which involved an absolute comparison between the tax the Wynnes paid on outbound income and the tax they would have paid on the same amount of in-state income. Maryland argued, however, that it met its constitutional obligation by setting its domestic and outbound taxes at the same rate.[96] Maryland argued that its only obligation was to avoid taxing residents' out-of-state income at a *higher rate* than their in-state income. Any additional taxes the Wynnes paid on non-Maryland income were assessed by source states, not by Maryland. Thus, according to Maryland, if the Wynnes suffered a cross-border tax disadvantage that discouraged them from engaging in cross-border commerce, the fault lay as much with the source state as with Maryland.[97] Maryland had no control over whether the source state taxed the Wynnes, and Maryland argued that the source state's tax should not preempt Maryland from taxing all its residents' income at the same rate, no matter where they earned it.[98]

The Wynnes did not object to the over-simplified tax rate comparison offered by Maryland, even though it included no comparison with taxes paid by the Wynnes' competitors. But to determine whether Maryland disadvantages cross-border commerce relative to in-state commerce requires a comparison of two comparisons; namely, we must compare (1) how Maryland taxes the Wynnes and other Maryland residents on their Maryland income compared to their out-of-state income with (2) how Maryland taxes nonresidents on their Maryland income compared to their out-of-state income. This comparison is fundamental for identifying violations of competitive neutrality. Instead, the Wynnes argued that double taxation violated the dormant Commerce Clause, and that, as their residence state, Maryland was obliged to relieve double state taxa-

Maryland rate on those earnings, and if the other state also taxed that income, they would pay more overall tax than they would have paid on the same dollar amount of income earned in Maryland.

[95] Wynnes' Brief, supra note 34, at 2.

[96] Maryland Comptroller's Brief, supra note 34, at 35.

[97] Id. at 27–32.

[98] Id. at 26–27.

tion.[99] Thus, the Wynnes' approach required them to argue that the Constitution included a priority rule that required the residence state to yield to the source state.[100] Source state priority to tax is well established in international tax.[101] And eminent state tax expert Walter Hellerstein argued that the Supreme Court in *Wynne* ought to have recognized the source state's priority to tax.[102] But Maryland argued that because there was no constitutionally mandated tax-priority rule, it was not clear which state, if any, had to relieve double taxation.[103] Thus, Maryland argued that its authority to tax its residents' out-of-state income was undiminished by the source state's authority to tax the same income.[104]

In our view, these double tax arguments are misdirected because they do not go directly to the question of whether the state used its tax system to discriminate against cross-border commerce by distorting competition between residents and nonresidents. As described in the last Part, whether a state tax regime violates the dormant Commerce Clause depends on its impact on cross-border commerce, not on whether it generates double taxation. The impact of a state tax regime on cross-border commerce cannot be understood by examining only its residence rules, despite the arguments of both the Wynnes and Maryland. Instead, understanding the impact of Maryland's tax regime on cross-border commerce requires examining its entire tax regime, comprised of inbound, outbound, and domestic taxes. The internal consistency test provides a court with a simple tool to examine the whole regime and to assess whether the regime discriminates against cross-border commerce.

Recognizing this, the Supreme Court set aside the litigants' framing and instead analyzed the Maryland regime under the internal consistency

[99] Wynnes' Brief, supra note 34, at 1–3; Transcript of Oral Argument at 36, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485).

[100] Transcript of Oral Argument at 35, Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) (No. 13-485). Specifically, Justice Kagan asked the Wynnes' counsel: "[Y]ou're not saying that . . . we should establish a priority rule as to different taxing schemes . . . are you?" Id. Counsel for the Wynnes replied: "I think that the holdings of this Court . . . are that in a situation where one State is taxing on the basis of residency and the other on the basis of source, it is the State of residency that yields." Id.

[101] Tax Discrimination, supra note 16, at 1027, 1027 n.54.

[102] Walter Hellerstein, Deciphering the Supreme Court's Opinion in *Wynne*, 123 J. Tax'n 4, 5–6 (2015).

[103] Maryland Comptroller's Brief, supra note 34, at 31.

[104] Id. at 26–44.

test.[105] Justice Alito wrote the majority opinion, joined by Chief Justice Roberts and Justices Kennedy, Breyer, and Sotomayor. Citing its own precedent, our amicus brief and that of the tax economists, and our academic work, the majority wrote:

> By hypothetically assuming that every State has the same tax structure, the internal consistency test allows courts to isolate the effect of a defendant State's tax scheme. This is a virtue of the test because it allows courts to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other States, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes. The first category of taxes is typically unconstitutional; the second is not. Tax schemes that fail the internal consistency test will fall into the first category, not the second: "[A]ny cross-border tax disadvantage that remains after application of the [test] cannot be due to tax disparities" but is instead attributable to the taxing State's discriminatory policies alone.[106]

When the Supreme Court applied the internal consistency test to Maryland's tax regime, it found the Maryland regime internally inconsistent, as had the Maryland Court of Appeals.[107] Unlike the Maryland Court of Appeals, which applied the test as a matter of doctrine, however, the Court in *Wynne* emphasized the connection between the test and the economic analysis provided by us and the tax economists.[108] The Court noted that the Maryland regime "has the same economic effect as a state tariff, the quintessential evil targeted by the dormant Commerce

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[105] *Wynne*, 135 S. Ct. at 1802.

[106] Id. at 1802 (alteration in original) (citing Armco, Inc. v. Hardesty, 467 U.S. 638, 644–46 (1984); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 277 n.12 (1978); Mobil Oil Corp. v. Comm'r of Taxes of Vt., 445 U.S. 425, 444 (1980); Gwin, White & Prince v. Henneford, 305 U.S. 434, 439 (1939); Tax Economists' Brief, supra note 25, at 23–24; Knoll Mason Brief, supra note 25, at 18–23; and quoting Ruth Mason, Made in America for European Tax, supra note 35, at 1310).

[107] Id. at 1803–05; Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 464–66 (Md. 2013).

[108] *Wynne*, 135 S. Ct. at 1804.

Clause."[109] It described the modern dormant Commerce Clause as "look[ing] to the economic impact of the tax."[110] And it noted that "[n]either [the Maryland Comptroller] nor the principal dissent questions the economic bona fides of the internal consistency test."[111] In particular, the Court acknowledged for the first time that the internal consistency test detects violations of competitive neutrality:

> [T]he internal consistency test reveals what the undisputed economic analysis shows: Maryland's tax scheme is inherently discriminatory and operates as a tariff . . . . This identity between Maryland's tax and a tariff is fatal because tariffs are "[t]he paradigmatic example of a law discriminating against interstate commerce."[112]

In affirming the usefulness of the internal consistency test in identifying the tariff-like impact of the Maryland tax, the Supreme Court cited our amicus brief and that of the tax economists.[113] The Court later reiterated that the purpose of the internal consistency test was to identify taxes that distort competitive neutrality when it declared that:

> In this case, the internal consistency test and economic analysis . . . confirm that the tax scheme operates as a tariff and discriminates against interstate commerce, and so the scheme is invalid.[114]

The tax regime violated the dormant Commerce Clause because it upset comparative advantage—it violated competitive neutrality and was thereby functionally equivalent to a tariff.

Importantly, eight of the nine justices agreed that the Constitution does not categorically forbid double taxation, and it does not contain a priority rule that says that residence taxes must give way to source taxes.[115] Thus, whereas most states avoid double taxation on a residence ba-

[109] Id. at 1792.

[110] Id. at 1796.

[111] Id. at 1802. See also id. at 1804 (reiterating that "[n]one of our dissenting colleagues dispute this economic analysis").

[112] Id. at 1804 (citing Tax Economists Brief, supra note 25, at 4, 9; Knoll Mason Brief, supra note 25, at 2; and quoting West Lynn Creamery v. Healy, 512 U.S. 186, 193 (1994)).

[113] Id.

[114] Id. at 1805.

[115] See id. ("We establish no such rule of priority."); id. at 1813 (Ginsburg, Scalia & Kagan, JJ., dissenting) ("[N]othing in the Constitution or in prior decisions of this Court dictates that one of two States, the domiciliary State or the source State, must recede simply because both have lawful tax regimes reaching the same income.").

sis, as do most countries—*Wynne* makes clear that such an outcome is not constitutionally required.

V. THE PRINCIPAL DISSENT

In applying the internal consistency test, the Court adopted by reference our economic analysis for determining when a state tax discourages cross-border commerce. But the majority merely referred to the economic analysis in our amicus brief and that of the tax economists.[116] It did not describe it or explain how that analysis applied to the facts in *Wynne*. Additionally, the majority borrowed language from the litigants who erroneously framed the case as asking whether double taxation was unconstitutional.[117]

Nor did the dissenting justices engage with the economics. Writing for the principal dissenters, Justice Ginsburg wrote that "[t]he majority faults the dissent for not 'disputing' its 'economic analysis,' but beyond citation to a pair of *amicus* briefs, its opinion offers no analysis to dispute."[118]

Justices Scalia and Kagan joined Justice Ginsburg's dissent, much of which reads as if the dissenting justices understood the majority opinion to hold that the dormant Commerce Clause forbids double taxation.[119] Likewise, the dissenters understood the majority to use the internal consistency test as a tool to combat double taxation.[120]

In this Part, we show that the dissenting justices' arguments are not responsive to the majority's reasoning. The Court endorsed the internal consistency test as a tool for determining when a state discriminates, that is, when it violates competitive neutrality by upsetting comparative ad-

[116] Id. at 1804.
[117] Id. at 1801–02.
[118] Id. at 1822 n.7 (Ginsburg, J., dissenting) (citing id. at 1803–04).
[119] See, e.g., id. at 1810 (Scalia, J., dissenting) (referring to "[t]oday's enterprise of eliminating double taxation"); id. at 1816 (Ginsburg, J., dissenting) (stating that the Court struck down the Maryland tax because it created "a risk of double taxation"); id. at 1822 n.10 (Ginsburg, J., dissenting) ("[G]iven the concern that purportedly drives the Court's analysis, it is mystifying why the Court sees virtue in striking down only one of the two schemes under which Bob is taxed twice.") (emphasis omitted).
[120] See, e.g., id. at 1822 (Ginsburg, J., dissenting) ("The Court characterizes internal consistency as a 'cure,' but the test is scarcely that, at least for the double taxation the Court believes to justify its intervention.") (citations omitted); id. (referring to "the double tax burden the test is purportedly designed to cure") (quotation marks omitted).

vantage.[121] But the internal consistency test does not identify double taxation, and the majority did not use it for that purpose. In fact, the majority expressly disclaimed the notion that all double taxation violates the Constitution.[122] Once we understand the distinction the majority drew between discrimination and double taxation, many of the concerns raised by Justice Ginsburg in her principal dissent and by Justice Scalia in his separate dissent disappear.

The dissenters make five main economic and policy (as opposed to doctrinal) arguments against using internal consistency to identify discrimination.[123] *First*, the test is abstract and hypothetical. *Second*, it does not root out double taxation. *Third*, the test is deeply flawed because Maryland could satisfy internal consistency by eliminating its inbound tax on nonresidents, even though such relief would not help the Wynnes. *Fourth*, despite the claims of the majority that the test identifies taxes that are functionally equivalent to tariffs, the Maryland tax did not resemble or function as a tariff since it taxed in-state and cross-border income at the same rate, whereas the defining characteristic of a tariff is that it taxes cross-border activity more heavily than in-state activity. *Fifth*, the internal consistency test "boxes in" states and undercuts state tax sovereignty. Although many of these criticisms overlap, we take them in turn.

[121] Id. at 1802–03.
[122] Id. at 1804.
[123] The dissenters also offer several interpretive and doctrinal arguments, which, if accepted, would leave no room for internal consistency. For example, Justices Scalia and Thomas both express skepticism that the Constitution includes a dormant Commerce Clause. Id. at 1808–10 (Scalia, J., dissenting); id. at 1811–13 (Thomas, J., dissenting). A majority of the Court, however, has long held otherwise. The principal dissent also argues that prior cases strongly support upholding Maryland's tax. Id. at 1814–23 (Ginsburg, J., dissenting). In contrast, the Court argues that the cases strongly support striking down the Maryland tax. Id. at 1795–1807. Although we agree more closely with the majority than the dissent here, we view many of the cases as inconsistent with one another. Along these lines, Justice Scalia argues that a "conspicuous feature" of the Court's tax discrimination doctrine has been "its instability" and characterizes that jurisprudence as producing a "bestiary of ad hoc tests." Id. at 1809 (Scalia, J., dissenting). We do not defend the history of the Court's tax discrimination jurisprudence, but rather offer a method that the Court can use to quickly and sensibly determine whether a given state tax discourages interstate commerce.

A. Internal Consistency is Abstract and Hypothetical

The dissenting justices (as well as commentators) have criticized the hypothetical nature of the internal consistency test.[124] The test operates by asking the reviewing court to make a counterfactual assumption, namely, that other states adopt the same tax system as the challenged state. The court then determines in this hypothetical world whether cross-border commerce bears more tax than in-state commerce. Of course, states do not all share the same tax system, so the constitutional inquiry strays from reality.

Critics have not made clear what disadvantages derive from the abstract and hypothetical nature of the internal consistency test. The test might seem unusual, but we showed in Part III that it closely mirrors the uniformity principle we developed in prior academic work, and the uniformity principle is firmly grounded in economics.[125] Uniformity is the key to nondiscrimination because it focuses on comparative advantage, rather than absolute advantage. If we are right that the tax nondiscrimination principle in the dormant Commerce Clause aims to eliminate tax-induced distortions of comparative advantage,[126] then internal consistency is an appropriate test to use because it correctly identifies tax-induced distortions to comparative advantage. That the test takes an unusual, abstract, or hypothetical form is irrelevant.

B. Internal Consistency Does Not Prevent Double Taxation

The principal dissent and Justice Scalia criticize the internal consistency test because it fails to root out all cases of double state taxation.[127] This criticism is unpersuasive because it is based on the errone-

[124] Id. at 1821 n.6 (Ginsburg, J., dissenting); id. at 1811 (Scalia, J., dissenting); Jasper L. Cummings, Jr., Internal Consistency and the Federal Income Tax, 145 Tax Notes 99, 99–100 (July 6, 2015).

[125] Tax Discrimination, supra note 16, 1060–74.

[126] For the doctrinal case for interpreting the dormant Commerce Clause to promote competitive neutrality, see Lirette & Viard, supra note 28, at 480–83, 500–03 (labeling the competitive neutrality concept we introduced in our E.U. work as commerce neutrality and neutrality with respect to interstate commerce, to emphasize its relevance to the dormant Commerce Clause).

[127] Justice Scalia's observation that the majority opinion does not eliminate all double taxation leads him to conclude that the Court's ruling leads to "imaginary benefits." *Wynne*, 135 S. Ct. at 1811 (Scalia, J., dissenting).

ous assertion that the majority in *Wynne* interpreted the dormant Commerce Clause to forbid double taxation.[128]

In her opinion for the principal dissent, Justice Ginsburg offered a simple and ostensibly powerful example of the failure of the internal consistency test to root out double taxation. She asked what would happen if one state, say, New Jersey taxed exclusively on a residence basis and offered no credits for source taxes, while simultaneously another state, say, Maryland taxed exclusively on a source basis? She explained that Maryland and New Jersey would each individually satisfy the internal consistency test. However, in actual practice (as opposed to the abstraction of the internal consistency test), the combination of these systems could result in full double taxation.[129] New Jersey residents with Maryland income would be taxed twice—first by Maryland on a source basis and then by New Jersey on a residence basis.[130] Justice Scalia made similar points.[131]

It is worth restating more generally the dissenters' objection: Internal consistency as a test of state tax discrimination would not prevent one state from taxing exclusively on a source basis while another state taxed exclusively on a residence basis with no credit for source taxes, even though the simultaneous application of such systems could result in unrelieved double tax. That description of the impact of the internal consistency test is correct, but it should not be understood as a defect of the test. Rather, it is a virtue of the test that it identifies discriminatory taxes without invalidating nondiscriminatory taxes that raise risks of double taxation.

The majority in *Wynne* understood this point. It did not hold that *all* double taxation violates the Constitution. On the contrary, the Court noted the existence of a "critical distinction . . . between discriminatory tax

[128] Justice Scalia erroneously characterizes the majority opinion as "[t]oday's enterprise of eliminating double taxation." Id. at 1810 (Scalia, J., dissenting).

[129] The combination of these schemes also could result in single taxation or "double non-taxation," where some taxpayers are not taxed at all. Single taxation would result for Maryland residents with only Maryland income and New Jersey residents with only New Jersey income. Double non-taxation would result for Maryland residents with only New Jersey income.

[130] *Wynne*, 135 S. Ct. at 1822 (Ginsburg, J., dissenting).

[131] Id. at 1810–11 (Scalia, J., dissenting).

schemes and double taxation that results only from the interaction of two different but nondiscriminatory tax schemes."[132]

The internal consistency test preserves Member State tax sovereignty to enact a variety of nondiscriminatory taxes, even if, in practice, those taxes could lead to double taxation. This parsimony is important because double taxation is neither a necessary nor sufficient condition for tax discrimination. We briefly review the distinction between double taxation and discrimination.

Obviously, a state can discriminate against cross-border commerce without imposing double taxation. Assume, for example, Maryland is the only state to tax, and assume that Maryland exempts residents' out-of-state income, maintains a 3% tax rate on residents' domestic income, and taxes nonresidents' Maryland income at 5%. Even if no other state imposed taxes, so that there could be no double tax, Maryland would discriminate against cross-border commerce. Nonresidents would face a tax-induced disadvantage compared to Maryland residents on income earned in Maryland because nonresidents would retain proportionately less of their income earned in Maryland *relative to* what they would retain of their revenue earned outside Maryland *as compared to* residents.[133] Thus, double taxation is not a necessary condition for discrimination.

To show that unrelieved double tax need not be discriminatory, we need to flesh out Justice Ginsburg's example. Assume Maryland imposes only a 20% source tax, and New Jersey imposes only a 10% residence tax. Maryland residents with New Jersey income would pay no tax; New Jersey residents with New Jersey income would pay only the New Jersey 10% residence tax; Maryland residents with Maryland income would pay only the Maryland 20% source tax; and New Jersey residents with Maryland income would pay both the New Jersey 10% residence tax and the Maryland 20% source tax, for a combined tax rate of 28%.[134]

[132] Id. at 1804.

[133] In our example, nonresidents retain 95% as much of their income when they earn income in Maryland rather than outside Maryland whereas residents retain 97% as much of their income when they earn income in Maryland rather than outside Maryland. Thus, Maryland taxes provide Maryland residents with a comparative advantage over nonresidents on income earned in Maryland.

[134] This assumes that a residence state would assess its tax upon the after-source-tax income of its residents (i.e., no gross-up). Thus, the combined tax rate of 28% is calculated as

$T_o + T_i - (T_o \text{ x } T_i)$: New Jersey residence tax [10%] + Maryland source tax [20%] – (New Jersey residence tax [10%] x Maryland source tax [20%]). See supra note 71.

Figure 3. Nondiscriminatory Double Taxation

	MARYLAND RESIDENT	NEW JERSEY RESIDENT
INCOME SOURCED IN NEW JERSEY	$T^{MD}_{outbound} = 0\%$ $T^{NJ}_{inbound} = 0\%$	$T^{MD} = N/A$ $T^{NJ}_{domestic} = 10\%$
INCOME SOURCED IN MARYLAND	$T^{MD}_{domestic} = 20\%$ $T^{NJ} = N/A$	$T^{MD}_{inbound} = 20\%$ $T^{NJ}_{outbound} = 10\%$ $T^{total} = 28\%$[135]

Each of the Maryland and New Jersey tax regimes is internally consistent.[136] Yet, when Maryland applies its regime at the same time that New Jersey applies its own, different (but also internally consistent) regime, differences arise in the number of *times* taxpayers are taxed (none, once, or twice) and in total *tax rates* they pay (0, 10%, 20% and 28%). The test does not identify—nor should it—a tax regime as constitutionally infirm simply because it results in different taxpayers paying tax at different absolute rates or because it results in double taxation. This is the right result because, as we explain below,[137] despite the tax differences the proposed Maryland and New Jersey regimes generate, neither regime impairs any taxpayer's ability to compete in either state. In other words, although the tax regime imagined by Justice Ginsburg results in

[135] See discussion in supra note 134.
[136] The Maryland tax is internally consistent because if all states adopted the Maryland tax system, all states would impose a 20% source tax and no other tax. Thus, both domestic and cross-border income would be taxed at exactly 20%. Similarly, the New Jersey tax is internally consistent because if all states adopted the New Jersey tax system, all states would impose a 10% residence tax and no other tax. Thus, both domestic and cross-border income would be taxed at exactly 10%.
[137] See discussion accompanying infra notes 139–40.

double taxation, it does not result in discrimination, if we understand discrimination to be violations of competitive neutrality.

The internal consistency test generates the proper result under an interpretation of nondiscrimination that promotes competitive neutrality and that recognizes that the impact of taxes on competitiveness depends upon how taxes affect comparative, not absolute, advantage. The aim of the dormant Commerce Clause is not to harmonize tax rates or ensure that cross-border taxpayers always pay the same tax rates as domestic taxpayers. Nor, as the majority in *Wynne* made clear, is it to alleviate double taxation.[138] On the contrary, the dormant Commerce Clause prevents states from using their tax systems to favor in-state commerce over cross-border commerce. And, in the example Justice Ginsburg gave, neither the Maryland nor New Jersey system (alone or together) favors in-state over cross-border commerce.

Neither state's tax policy upsets competition because each state's tax regime applies uniformly. The New Jersey tax applies on a uniform *residence* basis; New Jersey residents pay the New Jersey tax whether they earn domestic or outbound income. The Maryland tax applies on a uniform *source* basis; residents of both Maryland and New Jersey pay the Maryland source tax on their Maryland-source income. As a result, New Jersey residents take home 10% less after taxes than do Maryland residents with the same pre-tax income. Because that 10% difference exists whether that income arises in New Jersey or Maryland, the New Jersey residence tax does not distort competition between residents of New Jersey and Maryland. Similarly, everyone takes home 20% less after taxes on each dollar of income earned in Maryland as opposed to New Jersey. Because that same 20% difference exists regardless of whether the income is earned by a New Jersey resident or a Maryland resident, the Maryland source tax also does not distort competition between residents of New Jersey and residents of Maryland. Moreover, the two taxes together do not distort competition between Maryland and New Jersey residents for income in New Jersey and Maryland because both New Jersey and Maryland residents retain 80% as much of their pre-tax income

[138] *Wynne*, 135 S. Ct. at 1804.

when they earn income in Maryland as compared with when they earn income in New Jersey.[139]

Thus, competition is not distorted because residents of New Jersey and Maryland both retain proportionately (in the example both retain 80%) as much of their before-tax income when they earn income in Maryland as opposed to New Jersey. In order for a tax system to distort competition, it must produce a difference in these ratios across residents of different states.[140] Expressed slightly differently, none of the hypothesized Maryland source tax, the hypothesized New Jersey residence tax, or the combination of both taxes together distorts competition because neither tax alone—nor both taxes in combination—distorts comparative advantage.

Intuition might lead to the conclusion that unrelieved double taxation always distorts competition between taxpayers, but the kind of economic analysis we just provided shows the fallacy of that intuition. Sometimes, double taxation upsets competition, but other times it does not. The majority understands this elusive point when it explicitly refers to nondiscriminatory double taxation.[141]

Indeed, what made *Wynne* such a conceptually difficult case was precisely that it involved *discriminatory* double taxation. Moreover, as both the majority and principal dissent acknowledged, Maryland could satisfy the internal consistency test (and eliminate the discrimination) by taking steps that would eliminate or reduce the double taxation, such as reducing or eliminating outbound taxation, crediting foreign taxes, or eliminating inbound taxation. But Maryland could also achieve internal consistency (and eliminate discrimination) without alleviating double taxation: For example, Maryland could raise the domestic tax rate (the tax paid by Maryland residents on Maryland-source income) so that it equaled the combined tax on inbound and outbound income.

[139] Maryland residents retain 80% of their Maryland income and 100% of their New Jersey income; New Jersey residents retain 72% of their Maryland income and 90% of their New Jersey income. Because 72% is 80% of 90%, the tax systems do not change the relative amounts kept by residents of New Jersey and Maryland for investments in each state. Thus, the Maryland and New Jersey taxes (separately and together) do not distort competition because they do not change comparative advantage.

[140] Tax Discrimination, supra note 16, at 1060–74.

[141] *Wynne*, 135 S. Ct. at 1804 (calling the difference between discrimination and double taxation a “critical distinction”).

That Maryland could satisfy the internal consistency test (and cure discrimination) by raising the domestic tax rate, which does nothing to eliminate or reduce double taxation, is not a problem with or a flaw of the internal consistency test, but rather underscores that the internal consistency test in particular, and tax discrimination doctrine in general, are about preserving comparative advantage. That is, the dormant Commerce Clause prohibits discrimination, not double taxation.

Thus, the principal dissenters are correct that the internal consistency test will not identify all cases of double taxation, but they are wrong that this is a problem with the test. The beauty of the internal consistency test is its ability to distinguish between discriminatory and nondiscriminatory double taxation. Indeed, the internal consistency test does a much better job than unaided intuition in determining whether a tax system distorts competition.[142] Given that the Court has interpreted the dormant Commerce Clause to forbid only *discriminatory* double taxation, a test like internal consistency that can reliably distinguish discriminatory from nondiscriminatory double tax is invaluable.

That does not mean that the taxes in Justice Ginsburg's example create no distortions. In our modified version of Justice Ginsburg's example, the New Jersey tax discourages *New Jersey residence*, while the Maryland tax discourages *earning income in Maryland*. But neither tax, nor the combination of the two tax systems, gives a resident of Maryland or New Jersey an edge over a resident of the other state in securing a job or making an investment in either state. In other words, the tax regimes (implemented together or alone) do not distort competition between residents of Maryland and residents of New Jersey for work and investment in Maryland or New Jersey. The tax regimes do not distort competition between the taxpayers, despite the fact that some taxpayers experience double taxation while others do not.

[142] Due to its lack of an internal consistency test (or an equivalent), the Court of Justice for the European Union has encountered similar difficulty in determining the distortive impacts of varying tax systems. See, e.g., Mason, supra note 35; George W. Kofler & Ruth Mason, Double Taxation: A European "Switch in Time?" 14 Colum. J. Eur. L. 63 (2007) (criticizing the Court of Justice's approach in double tax cases).

C. Maryland Could Satisfy Internal Consistency Via Methods that Would Not Benefit the Wynnes

The principal dissent makes another argument that overlaps with its argument that the internal consistency test does not eliminate all cases of double taxation. The dissenters criticize the internal consistency test because Maryland can satisfy it by amending its law in a way that would not benefit the Wynnes. Justice Ginsburg writes:

> Maryland could eliminate the inconsistency by terminating the [inbound] tax—a measure that would not help the Wynnes at all. Maryland could, in other words, bring itself into compliance with the test at the heart of the Court's analysis without removing the double tax burden the test is purportedly designed to "cure."[143]

Justice Ginsburg is correct in recognizing that Maryland can cure its constitutional infirmity without reducing the Wynnes' taxes. Maryland could resolve its constitutional infirmity by taking any of the following actions: (1) lowering the outbound tax rate, (2) crediting out-of-state taxes, (3) raising the domestic tax rate, or (4) eliminating the inbound tax.[144] Any of the four options (and countless combinations of them) would satisfy the internal consistency test, but only the first two would decrease the Wynnes' absolute tax burden.[145]

According to the principal dissent, the possibility that Maryland could cure its constitutional violation without directly benefiting the Wynnes reveals "a deep flaw" in the Court's internal consistency test.[146] The majority responded to the dissent's criticism by arguing that remedies in discrimination cases often possess this characteristic: The discrimination can be cured by leveling up the treatment of the disfavored group, or leveling down the treatment of the favored group. But the principal dissent argued that the situation was different in *Wynne* because leveling up the treatment of the nondiscriminated class by lowering the inbound tax would benefit only nonresidents in Maryland.[147] It would do nothing, in

[143] *Wynne*, 135 S. Ct. at 1822 (Ginsburg, J., dissenting) (citations omitted).
[144] Id. at 1806 (citing Knoll Mason Brief, supra note 25, at 28–30).
[145] Id. at 1822–23 (Ginsburg, J., dissenting). The third option, raising the domestic tax rate, would also cure the discrimination, but it would not appear to benefit the Wynnes directly either. That option was not discussed by the principal dissent.
[146] Id. at 1822 (Ginsburg, J., dissenting).
[147] Id. at 1823 (Ginsburg, J., dissenting).

the dissenters' view, to help residents like the Wynnes, who, according to the majority, faced discrimination by Maryland against their out-of-state income.

This criticism fails to recognize that taxes impact competition by changing comparative advantage, not by changing absolute advantage. It is true that fixing the constitutional infirmity by one of the latter two options—raising the domestic tax or eliminating the inbound tax—will not reduce the Wynnes' absolute tax burden. It would, however, improve their competitive position. It might be counterintuitive, but the Maryland tax regime actually disadvantages the Wynnes in their competition with non-Maryland residents *outside Maryland*. In our terms, it is retentionist. As a result, lowering or repealing the inbound tax would confer an advantage upon the Wynnes and all other Marylanders who compete for income outside the state.

To see why this is so, return to our two-state example from Part III, where New Jersey represents all states other than Maryland. Residents of both New Jersey and Maryland allocate investment and work effort between New Jersey and Maryland. Because New Jersey and Maryland are the only two markets, a taxpayer's competitive position in New Jersey depends upon how that taxpayer is taxed in New Jersey *relative to* how that taxpayer is taxed in Maryland as *compared to* how that taxpayer's competitors are taxed in New Jersey *relative to* how they are taxed in Maryland. Accordingly, eliminating the inbound tax would improve the competitive position of New Jersey residents in Maryland, thereby worsening their competitive position in New Jersey, thus benefitting the Wynnes.

In other words, the Maryland tax regime held unconstitutional by the Court has two effects that go in opposite directions: It keeps residents in, and it keeps nonresidents out. It is retentionist and protectionist. We have argued that such bidirectional distortions are the hallmark of tax discrimination,[148] but they are not always obvious. It is obvious that if Maryland introduced a stand-alone inbound income tax as its only tax, such tax would discourage New Jersey residents from earning income in Maryland; the tax would protect the Maryland market from New Jersey residents. But, although less obvious, Maryland's protectionist tax

[148] See Tax Discrimination, supra note 16, at 1056–60 (referring to a "two-directional distortion").

would impact the market in New Jersey, too. By using the inbound tax to keep New Jersey residents out of Maryland, Maryland makes it harder for *its own residents* to compete with New Jersey residents *in New Jersey*.[149] Eliminating the inbound tax would bring more New Jersey residents into Maryland, freeing up opportunities for Marylanders in New Jersey. The same logic applies when a state imposes an inbound tax on top of a uniform source tax, which is precisely the Maryland tax system struck down in *Wynne*. Thus, despite the principal dissent's argument, eliminating Maryland's inbound tax indeed would benefit the Wynnes by making it easier for them to compete in New Jersey.

D. The Tariff Critique

Because Maryland taxed the Wynnes' Maryland income at the same rate as their out-of-state income, Justice Ginsburg objected that the majority's use of the term "tariff" to refer to the Maryland tax regime was inapt. She wrote:

> The majority asserts that because Maryland's tax scheme is internally inconsistent, it "operates as a tariff," making it "patently unconstitutional." This is a curious claim. The defining characteristic of a tariff is that it taxes interstate activity at a higher rate than it taxes the same activity conducted within the State. Maryland's resident income tax does the exact opposite: It taxes the income of its residents at precisely the same rate, whether the income is earned in-state or out-of-state.[150]

The Court uses the term "tariff" to describe taxes that fail the internal consistency test. Lirette and Viard introduced the tariff analogy in their work, and the tax economists used it throughout their amicus brief. The Court adopted the tax economists' terminology, but it did not explain why. This Part explains why the tariff analogy is appropriate.

When a challenge is to a state's tax rates, the internal consistency test requires a state's domestic tax rate to *equal or exceed* its combined outbound and inbound tax rates.[151]

[149] For formal analysis of this phenomenon, see Tax Discrimination, supra note 16, at 1057–60 (analyzing residence-based distortions of competitive neutrality).
[150] *Wynne*, 135 S. Ct. at 1821–22 (Ginsburg, J., dissenting) (citations omitted).
[151] See discussion supra Part III.

If the domestic rate *equals* the combined inbound and outbound rates, then the tax system is *neutral* toward cross-border commerce.[152]

If, however, the domestic tax rate *exceeds* the combined inbound and outbound rates, the tax system *prefers* cross-border commerce over in-state commerce. That is, the state creates a tax-induced competitive advantage for its residents over nonresidents when earning income outside the state (outbound incentive), and it simultaneously creates a tax-induced competitive advantage for nonresidents over its own residents when earning income within the state (inbound incentive). Such tax regimes are sometimes referred to as "reverse discrimination," but so far, the Supreme Court has not invalidated them under the dormant Commerce Clause.[153]

The final possibility is that the domestic tax rate *is less than* combined inbound and outbound tax rates. In this case, the tax system fails internal consistency and *discourages* cross-border commerce compared to in-state commerce. That is, the state creates a tax-induced competitive advantage for its residents over nonresidents when earning income inside the state (protectionism), and it simultaneously creates a tax-induced competitive advantage for nonresidents over its own residents when earning income outside the state (retentionism). The amount by which the state's cross-border tax (i.e., the aggregate of the inbound and outbound taxes) exceeds the domestic tax is equivalent to an additional tax on cross-border income (compared to in-state income). That additional tax can be thought of as functionally equivalent to a tariff on cross-border commerce.

The internal consistency test shows that Maryland taxes in-state commerce at 3.2% and cross-border commerce at 4.45%. There are many ways of thinking about Maryland's additional 1.25% tax on cross-

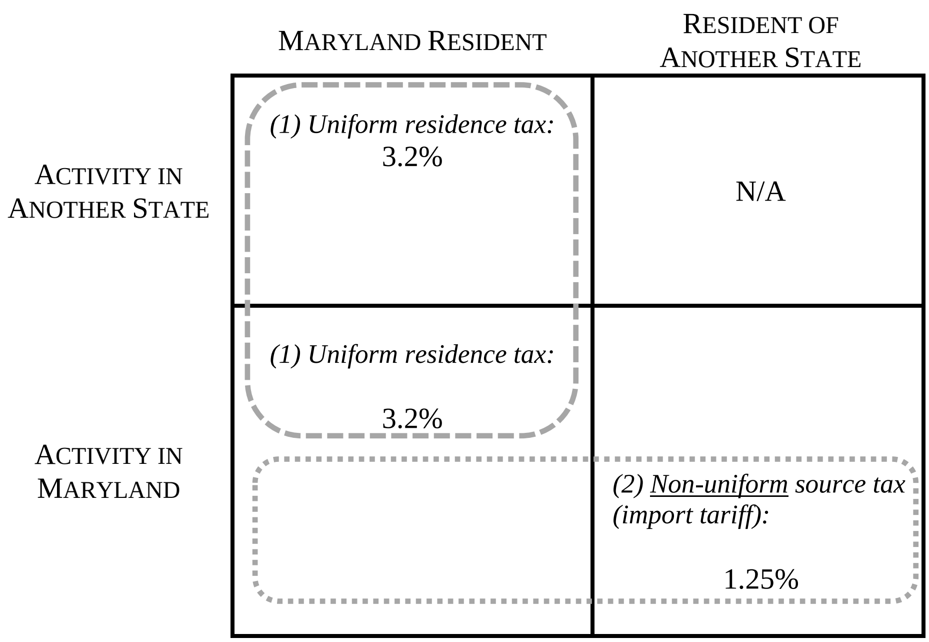
[152] That is to say, apply *Condition 1* with an equality instead of an inequality.

[153] See West Lynn Creamery v. Healy, 512 U.S. 186, 199 (1994) (striking down a Massachusetts direct subsidy to in-state milk producers because it was funded by a tax on in-state and out-of-state milk wholesalers, but declaring that "[a] pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business"). But see Cuno v. DaimlerChrysler, Inc., 386 F.3d 738, 741 (6th Cir. 2004), vacated in part, 547 U.S. 332 (2006) (invalidating under the Commerce Clause a tax credit extended by Ohio against its franchise tax to DaimlerChrysler in exchange for the company's location of assets in Toledo).

border commerce as a tariff, and we consider two here.[154] One way to think about the Maryland tax regime is that it functions as an *import tariff*. The import tariff emerges when we decompose the Maryland regime into: (1) a uniform 3.2% residence tax on both domestic and outbound activities (in *Figure 4*, the taxes inside the dashed line), which leaves (2) a residual non-uniform 1.25% tax on inbound income (in *Figure 4*, the tax inside the dotted line).

[154] We consider only the two extremes here: Either the whole 1.25% extra burden on interstate commerce functions as an import tariff, or it functions wholly as an export tariff.

Figure 4. Maryland Tax Regime as Import Tariff



On this view, the 1.25% non-uniform inbound tax is analogous to a 1.25% import tariff because it discourages nonresidents from engaging in economic activities in Maryland.

Another way to think about the Maryland tax regime is that it functions as an *export tariff*. The export tariff emerges when we decompose the Maryland regime into: (1) a 1.95% uniform residence tax on both domestic and outbound activities (in *Figure 5*, the taxes inside the long dashed line), plus (2) a 1.25% uniform source tax on Maryland activities by both residents and nonresidents (in *Figure 5*, the taxes inside the short dashed line). This decomposition leaves (3) a residual (non-uniform) 1.25% on residents' outbound income (in *Figure 5*, the tax inside the dotted line):

Figure 5. Maryland Tax Regime as Export Tariff

	MARYLAND RESIDENT	RESIDENT OF ANOTHER STATE
ACTIVITY IN ANOTHER STATE	*(1) Uniform residence tax:* 1.95% *(3) Non-uniform residence tax (export tariff):* 1.25%	N/A
ACTIVITY IN MARYLAND	*(1) Uniform residence tax:* 1.95% *(2) Uniform source tax*: 1.25%	*(2) Uniform source tax:* 1.25%

The non-uniform tax on residents' outbound income functions as an export tariff because it discourages Maryland residents from earning income outside Maryland.

The preceding exercise underscores several important points. First, like tariffs, discriminatory income taxes distort production. Discriminatory income taxes distort where people earn income just as tariffs distort where people produce goods and services.[155] Second, tariffs and discriminatory income taxes distort via the same mechanism: They upset comparative advantage. Third, our demonstration that there are multiple ways to decompose an internally inconsistent tax regime—into an internally consistent tax plus a residual, where the residual functions as a tariff—underscores the importance of considering domestic, inbound, and outbound tax rates together to assess discrimination. It also highlights

[155] Put another way, discriminatory income taxes distort who works what job or owns which asset; tariffs distort which country produces which goods and services.

the two-directional aspect of discriminatory taxes. Discriminatory taxes simultaneously discourage inbound and outbound commerce—they protect against out-of-state economic actors and they retain in-state economic actors. This effect, too, is similar to tariffs, which are simultaneously protectionist and retentionist.

Our exercise in decomposing Maryland's tax regime into, alternatively, a uniform-source-tax-with-a-residual or a uniform-residence-tax-and-a-uniform-source-tax-with-a-residual aids in understanding the tariff analogy, but it is not necessary for a court to reconceptualize the challenged tax regime in those ways. All a court has to do to determine if the tax discriminates is to apply the internal consistency test. Economic analysis shows that a failure of internal consistency means the tax regime functions as a tariff.

E. The State Sovereignty Critique

Justice Ginsburg for the principal dissent and Justice Scalia writing separately both argued that the Court's dormant Commerce Clause doctrine compromises state sovereignty. The principal dissent argued that the Court's holding in *Wynne* "boxes in the taxing authority of a taxpayer's domicile."[156] This Part responds that, by itself, this criticism has little force, since the function of dormant Commerce Clause doctrine is to constrain state power. Moreover, the majority's renewed commitment to the internal consistency test helps preserve state tax sovereignty compared to using bald intuition to decide tax discrimination cases.

1. Majority "Boxes In" States

The principal dissent correctly observes that the majority's decision implies that a state's source taxes "box in" that same state's residence taxes.[157] The internal consistency test precisely states the nature of that

[156] *Wynne*, 135 S. Ct. at 1813 (Ginsburg, J., dissenting).

[157] Id. Although the "boxing in" language is somewhat colloquial, neither the meaning nor the import of the claim is clearly explained by the principal dissent. Indeed, the principal dissent seems to be making two somewhat different claims with its "boxing in" criticism. In the first use of the phrase, the principal dissent seems to be claiming that under the Court's reasoning, the manner in which a source state taxes income "boxes in" how *another state* (that of a taxpayer's residence) can tax a resident taxpayer with income from the source state. See id. Neither the internal consistency test nor the uniformity principle conditions one state's taxes (say Maryland's) upon a second state's taxes (say New Jersey's). In the second use of

constraint: A state's tax on cross-border income (comprised of its tax on inbound income plus its tax on outbound income) cannot be greater than its tax on domestic income. In other words, the state's tax rates must obey *Condition 1*: $T_d \geq T_o + T_i - (T_o \times T_i)$.[158]

We are not sure why the dissent considers such constraints to be a problem, especially since the dissenters' preferred rule would also "box in" the states. Rather than arguing, as did Justice Thomas,[159] that the dormant Commerce Clause places no constraints on how states may tax cross-border commerce, the principal dissent argued that states violate the dormant Commerce Clause when they assess higher absolute tax rates on inbound or outbound commerce than on domestic commerce.[160] In other words, like the Maryland Comptroller, the principal dissent reads the constitutional requirement as equivalent to *Condition 2*, $T_d \geq T_i$ *and* $T_d \geq T_o$. Like *Condition 1*, *Condition 2* also "boxes in" how states may tax.[161] Thus, under both the Court's and the principal dissent's articulation of the test for tax discrimination, states lack unfettered tax discretion, and a decision by a state about how to tax on either a source or residence basis will restrain how that state can tax on the other basis.

Accordingly, the disagreement between the majority and the principal dissenters in *Wynne* is best understood as a disagreement over economics: When do state taxes discourage cross-border commerce in a consti-

the phrase, Justice Ginsburg explains that "[m]y objection, rather, is that the Court treats source-based authority as 'boxing in' a State's discrete authority to tax on the basis of residence." Id. at 1822 n.9 (Ginsburg, J., dissenting). Likewise, Justice Ginsburg asserts that "the Constitution does not . . . require one State, in this case Maryland, to limit its residence-based taxation, should the [same] State also choose to exercise, to the full extent, its source-based authority." Id. at 1813–14. This latter description of the implications of the majority's holdings, that a state's own residence taxation constrains that same state's source taxation, is accurate and so we assume that this second claim is the import of the principal dissent's criticism.

[158] This is true for cases, like *Wynne*, that involve a challenge only to tax rates in a system without tax credits. For challenges involving the tax base or tax credits, the analysis is more complicated. See Perseus, supra note 27, at 419–22. Although the principal dissent does not mention it, another direct implication of the Court's ruling is that how a state taxes on a residence basis also boxes in how it can tax on a source basis. Under the majority's holding, a state's source taxes constrain its residence taxes, and its residence taxes constrain its source taxes.

[159] *Wynne*, 135 S. Ct. at 1811–13 (Thomas, J., dissenting).

[160] Id. at 1818 n.5 (Ginsburg, J., dissenting).

[161] Although *Condition 1* is stricter than *Condition 2*, both "box in" the states.

tutionally relevant way? Maryland and the dissenters argue that states only violate the Constitution when they assess lower taxes on domestic income than *either* inbound or outbound income. But if the goal is to prevent states from discouraging cross-border commerce compared to in-state commerce, then the correct standard to use from an economics perspective is one that compares the state's domestic tax to the *aggregate of its taxes on inbound and outbound income.* The internal consistency test is a quick, easy, and reliable way to compare the challenged state's domestic tax to the aggregate of its inbound and outbound taxes.

In contrast, taxing domestic, inbound, and outbound income all at the same rate without providing a credit for out-of-state taxes, which would be permitted under an interpretation of the dormant Commerce Clause that required fidelity only to *Condition 2*, would discourage cross-border commerce relative to in-state commerce. The principal dissent's position would open the floodgates to state taxes that function as tariffs, even though the dissenters recognize that the purpose of dormant Commerce Clause doctrine is to prevent such obstacles to the national market.

It is neither a surprise nor a devastating criticism that the dormant Commerce Clause constrains state taxes. The Court has long held that the dormant Commerce Clause restrains state sovereignty in taxation.[162] We have shown that the internal consistency test reveals whether a challenged state exceeds its tax authority by assessing unconstitutionally discriminatory taxes that impair cross-border commerce by upsetting competitive neutrality. A virtue of the internal consistency test is that it goes no further than necessary to achieve this goal. For example, under the majority's analysis and under the internal consistency test, Maryland's choices about its source taxes constrain *its own* residence taxes and vice versa. But *other* states' tax rate choices constrain neither Maryland's source nor its residence taxes. Under a competitive neutrality conception of nondiscrimination, each state sets its taxes independently of every other state, but no state may set its source taxes independently of its own residence taxes, or vice versa.

Thus, the uniformity principle and internal consistency test provide states with wide, but not unfettered, discretion. States have wide flexibility to set tax rates high or low, to allocate tax liability between residence

[162] See *Wynne*, 135 S. Ct. at 1794.

and source taxation, and to tax progressively or not.[163] At the same time, there are also clear lines that states cannot cross, where their policies discourage cross-border commerce relative to in-state commerce.

2. Other Concerns for State Tax Sovereignty

Justice Scalia argued that the Court usurped the role of state and national legislatures by balancing the needs of the national marketplace against the needs of state governments for revenue.[164] Similarly, Justice Ginsburg argued that:

> States deciding whether to tax residents' entire worldwide income must choose between legitimate but competing tax policy objectives. A State might prioritize obtaining equal contributions from those who benefit from the State's protection in roughly similar ways. Or a State might prioritize ensuring that its taxpayers are not subject to double taxation. A State cannot, however, accomplish both objectives at once.[165]

And she concluded that:

> This case is, at bottom, about policy choices: Should States prioritize ensuring that all who live or work within the state shoulder their fair share of the costs of government? Or must states prioritize avoidance of double taxation? As I have demonstrated, achieving even the latter goal is beyond this Court's competence. Resolving the competing tax policy considerations this case implicates is something the Court is even less well equipped to do. For a century, we have recognized that state legislatures and the Congress are constitutionally assigned and institutionally better equipped to balance such issues.[166]

These quotations illustrate that the principal dissent sees a conflict between fairness and efficiency. In their view, efficiency calls for the elimination of double taxation. In contrast, fairness requires roughly equal contributions from residents who benefit from state-provided goods and services, no matter where they earn their income. The attainment of both

[163] Perseus, supra note 27, at 417–19.
[164] *Wynne*, 135 S. Ct. at 1810 (Scalia, J., dissenting).
[165] Id. at 1816 (Ginsburg, J., dissenting).
[166] Id. at 1823 (Ginsburg, J., dissenting) (citations omitted).

would be ideal, in Justice Ginsburg's view, but it is not possible. States must choose between them and balance.

We disagree. In our view, the uniformity principle is the path toward pursuing both goals. As described above, in the dormant Commerce Clause context efficiency requires uniformity; it requires maintenance of comparative advantage, but it does not require avoidance of double taxation.

But the uniformity principle does not prevent a state from levying the same taxes on its residents, no matter whether they earn their income in-state or out-of-state. States can even maintain an equal-burden regime for residents without crediting other states' source taxes. But to maintain competitive neutrality, such states must adhere to internal consistency and *Condition 1*. Thus, after *Wynne*, if Maryland wishes to continue to tax Marylanders' domestic income and their out-of-state income at the same rate without crediting other states' source taxes, it may do so, but to avoid constitutional infirmity, it would have to repeal its inbound tax. Thus, there is no necessary conflict between equal treatment of residents' income and the dormant Commerce Clause.

Although the facts of *Wynne* highlight Maryland's role as a residence state, Maryland is also a source state, and in that capacity, it confers benefits on nonresidents. The uniformity principle allows Maryland or any other state to decide how much tax liability to allocate to residence taxation and how much tax liability to allocate to source taxation. But it does not allow a state to design its residence tax independently of its source tax. States therefore have autonomy to allocate tax liability in line with the benefits principle, but they cannot discriminate against cross-border commerce. Such an approach is consistent with taxing according to ability to pay because it permits states to tax their residents' worldwide income with a credit for taxes paid to other jurisdictions, which is widely viewed as a fair method of taxing individuals.[167]

CONCLUSION

Wynne is the Court's most important state tax case in decades. After narrowing it over the last three decades, the Court renewed and expanded its commitment to the internal consistency test in *Wynne*. Equally important, the Court acknowledged for the first time that economic analy-

[167] Tax Discrimination, supra note 16, at 1027.

sis supports the notion that internal consistency is the right test to use for identifying unconstitutional state tax discrimination because the test correctly identifies cases in which a state's tax regime upsets comparative advantage between resident and nonresident taxpayers.

Wynne thus provides a way out of the "tangled underbrush" of dormant Commerce Clause doctrine to a future with clear, sensible decisions. While there may be some truth in Justice Scalia's criticism that the Court's interpretation of the dormant Commerce Clause prior to *Wynne* involved "ad hocery" that "lack[ed a] . . . governing principle," the majority's recognition of the economic principles undergirding the dormant Commerce Clause places the doctrine on firmer footing. And the Court's confirmation that the internal consistency test should be applied to resolve every kind of state tax discrimination case gives lower courts clear direction.

The challenge of dormant Commerce Clause doctrine is balancing state tax sovereignty against the national interest in a smoothly functioning national economy that benefits U.S. workers, investors, and consumers. By ruling out internally inconsistent state taxes, *Wynne* clarifies that balance. *Wynne* stands for the proposition that states have wide range to set their own tax regimes, but that flexibility comes to an abrupt end when a state enacts a tax regime that discriminates against cross-border commerce. As our analysis shows, a state discriminates against cross-border commerce when it discourages cross-border commerce relative to in-state commerce. This occurs when it disadvantages out-of-state actors relative to in-state actors in the competition to engage in economic activity in the taxing state (protectionism) and when it disadvantages in-state actors relative to out-of-state actors in the competition to engage in economic activity outside the taxing state (retentionism). Such discrimination tends to "balkanize" the national market by dividing it into separate state markets where residents have a tax-induced competitive advantage over nonresidents.

To realize the potential of *Wynne*, however, the Court must remain true to its central conclusions in the case—*first*, the problem addressed by the dormant Commerce Clause is not double taxation, but rather discrimination against cross-border commerce; *second*, a state discriminates when it uses its tax system to upset comparative advantage; *third*, economic analysis supports the use of the internal consistency test to uncover state taxes that distort comparative advantage; *fourth*, the Constitution does not establish a priority rule between source and residence taxation; and *fifth*, discrimination claims can only be evaluated by examining the state's full tax system, including its domestic, inbound, and outbound taxes.